REPORT OF LIMITED SCOPE EXAMINATION
OF THE

ALISTAR INSURANCE COMPANY

AS OF
DECEMBER 31, 2001

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San Francisco, California
March 21, 2002

Honorable Harry W. Low
Insurance Commissioner
California Department of Insurance
Sacramento, California

Dear Commissioner:

Pursuant to your instructions, an examination was made of

ALISTAR INSURANCE COMPANY

(also referred to as the Company) at its home office located at 616 "P" Street, Fresno, California 93721.

SCOPE OF EXAMINATION

This is a limited scope examination as of December 31, 2001, which included an actuarial analysis of losses and loss adjustment expenses as of December 31, 2001, confirmation of the Company's cash and invested assets and a statutory compliance review of reinsurance ceded agreements. The examination was originally scheduled to cover the period from January 1, 1997 through December 31, 1999. Because of significant subsequent events, the examination was rolled forward through subsequent periods concluding with December 31, 2001.

SUMMARY OF SIGNIFICANT FINDINGS

The Company reported surplus as regards policyholders of $939,921 in its filed Annual Statement as of December 31, 2001. Based on this amount of surplus, the Company is deemed insolvent as defined in California Insurance Code (CIC) Section 985. The Company's surplus as determined by this examination was $(3,070,099) which is $7,170,099 less then the Company's required capital and surplus of $4,100,000 pursuant to CIC Sections 700.01, 700.02 and 700.025.

This level of surplus places the Company at the Mandatory Control Level for Risk-Based Capital.

Due to deteriorating loss experience, the Company on December 28, 2001 gave 90-days notice to terminate its agreement with CenCal Insurance Services (CenCal) to write nonstandard auto business. After the termination of new and renewal premium for the Company, the Company currently plans for CenCal to retain its claims handling duties.

In 2001, the non-standard automobile business was reinsured under a 50% quota share reinsurance agreement. However, the Company in 2002 has not been able to secure reinsurance for this line. This inability to obtain reinsurance will have a negative financial impact on the Company, as the non-standard automobile business has not been profitable for the Company. The negative financial impact is also exacerbated by the fact that CenCal during the first two months of 2002 has significantly increased premium writings as compared to the average monthly writings in 2001. Additionally, the Company is mandated by the California Insurance Code to continue to renew policies for those policyholders that wish to renew their auto policy with the Company. This obligation remains even after the termination of the general agency agreement with CenCal, which becomes effective on March 28, 2002.

Due to continuing losses in its workers' compensation line, the Company ceased writing this line in January 2000. This book of business is currently in a run-off mode. However, the Company, reentered the workers' compensation market in February 2001. The Company wrote a program that was limited to small employers and certain class codes. The Company ceased writing this book of business in December 2001.

In April 2001, nine bail agents that work for R. Spencer Douglass (RSD) in Riverside, California were arrested on a 222-felony count complaint. RSD currently writes bail bond business on behalf of the Company under a general agency agreement. The complaint accused RSD's employees, among other things, of paying prison inmates for business referrals and giving them free three-way telephone calls. On May 7, 2001, RSD and one of the corporate vice presidents of Spencer Douglass Incorporated (wholly owned by RSD) were arrested and named as codefendants on the 222-felony count complaint. Also during May 2001, RSD was again arrested along with the same corporate vice president and charged with an additional felony count of filing false evidence with the court. The latter charges related to two allegedly invalid bail bonds ($5 million and $1 million) that RSD and the corporate vice president had issued through Frontier Pacific Insurance Company, which had voluntarily ceased writing business. RSD is of the opinion that the charges against him and his vice president are without merit and that ultimately both of them will be vindicated of all charges. However, if RSD is convicted of any of the felony charges in the future, his license to produce bail bond business may be adversely affected.

COMPANY HISTORY

As of December 31, 1996, the date of the last examination, all of the outstanding stock of the Company was held by Mr. Vahan Chamlian. On July 6, 2000, Chamlian Financial Group (CFG) acquired the outstanding shares of the Company, and became the parent of the Company. Mr. Vahan Chamlian is the sole shareholder of CFG. On December 17, 2001, CFG filed a certificate of dissolution with the California Secretary of State. As a result, all of the issued and outstanding shares of common stock were distributed to Mr. Chamlian.

During the period of this examination, Mr. Vahan Chamlian, contributed $12.5 million in surplus contributions. The contributions were comprised of $8.82 million in cash and the Company's home office building, which was valued at $3.68 million at the time of the contribution. The Company on April 21, 2000 sold its home office building to Vahan and Anoush Chamlian in exchange for $3.2 million in cash and a $500,000 promissory note. The promissory note is secured by a deed of trust on a parking lot located at the back of the home office building.

MANAGEMENT AND CONTROL

As of December 31, 2001, the ultimate controlling person was Mr. Vahan Chamlain, who also owns other businesses that are involved in textile, recycling, real estate, and insurance.

The six-member board of directors manages the business and affairs of the Company. Following are members of the board of directors and the principal officers of the Company serving as of December 31, 2001:

Directors

Name and Residence	Principal Business Affiliation
Monique Chamlian Bouskos Fresno, California	Co-Owner and Director HealthComp, Inc.
Anoush Chamlian Fresno, California	Co-Owner and Director HealthComp, Inc.
Ketty Chamlian Fresno, California	Executive Vice President Alistar Insurance Company
Vahan Chamlian Fresno, California	Chairman of the Board Alistar Insurance Company
Michel Noblat Fresno, California	Retired Formerly Chief Financial Officer of Sumner Peck Ranch, Inc.
John R. Sosak (1) Fresno, California	President and Chief Executive Officer Alistar Insurance Company

Principal Officers

Name	Title
Vahan Chamlian	Chairman of the Board
John R. Sosak (1)	President and Chief Executive Officer
Ketty Chamlian	Executive Vice President
Mark Pasculli	Executive Vice President, Chief Financial Officer and Chief Operating Officer
S. Kim Jackson	Secretary and Controller

(1) resigned on January 7, 2002 and replaced by Mark Pasculli

On November 5, 2001, the Board of Directors passed a motion to compensate Mr. Chamlian in the amount of $259,158 for his salary for the years of 1998, 1999, and 2000. This was in addition to the $309,442 Mr. Chamlian received on January 3, 2000 as partial payment for those years. On November 9, 2001, Mr. Chamlian made a $250,000 payment on the $500,000 promissory note held by the Company.

Inter-Company Agreements

The Company entered into an Equipment Lease Agreement with its affiliate, CFG, effective January 1, 1998. Pursuant to this agreement, the Company leases from CFG certain office equipment, computers, software and furniture for $40,000 per month. This agreement had been sent to and was reviewed by the California Department of Insurance. Subsequently, the Company agreed to reduce the fee to $35,000 per month for the remainder of the term of this agreement, specifically from April 1, 2000 through December 31, 2000. Effective January 1, 2001, the fee was further reduced to $16,000 per month.

The Company entered into a Postage Meter Usage Agreement with HealthComp, Inc. (HealthComp) effective January 1, 1996. HealthComp is a third party administrator that is 100% owned by the Chamlian Family. Under this agreement, the Company agreed to reimburse HealthComp for the actual cost of postage used by the Company. In addition, the Company has a Third-Party Administration Agreement with HealthComp effective March 1, 1996. In this agreement, HealthComp agreed to administer employee benefits under the Company's self-insured dental and vision plans.

TERRITORY AND PLAN OF OPERATION

As of December 31, 2001, the Company was licensed to transact multiple lines of property and casualty insurance in California. During 1998, the Company began writing nonstandard auto liability and physical damage insurance. In 2001, gross written premiums for all lines amounted to $62.1 million. The nonstandard auto line accounted for 41% of the gross written premiums; surety for 56%, workers' compensation for 2%; and employer practice liability for 1%.

The Company's nonstandard auto business is written throughout California. In 2001 and 2000, the Company had gross written premiums of $25.8 million and $16.9 million, respectively. The nonstandard auto business is written through a managing general agent, CenCal Insurance Services (CenCal), located in Danville, California.

The Company entered into a general agency agreement with CenCal that became effective on March 1, 1998. In this agreement, CenCal agreed to produce and underwrite nonstandard auto business for the Company. Its duties also included premium collection and claims handling. The Company agreed to pay a 19% commission, 60% of policy, billing, and filing fees, and a contingent commission to CenCal. In addition, the Company agreed to pay CenCal a claims-handling fee of $175 per bodily injury and/or property damage claim and $75 per comprehensive and collision claim.

The agreement with CenCal was amended in November of 2001 to increase CenCal's retention of the policy fees to 65%. The 65% retention is effective for one year at which time the retention will revert back to the 60%. On December 28, 2001, due to deteriorating loss experience, the Company terminated its agreement with CenCal to write premiums as of March 28, 2001. The claims handling arrangement, however, will continue at the present time.

During the latter part of the third quarter of 2000, the Company also began writing surety appearance bonds (bail bonds). In 2000, the Company wrote $8.6 million in bail bond premiums. Premium writings in 2001 were $34 million. The bail bond business is produced through R. Spencer Douglass (RSD). The Company's book of business is the California bail bond business that was previously written by insurers within the Frontier Insurance Group (Frontier). RSD placed the book with the Company when Frontier's insurance subsidiaries encountered financial difficulties and voluntarily ceased writing business.

REINSURANCE

Assumed

The Company did not assume any traditional reinsurance during the period under examination. However, the Company received the consent of the California Department of Insurance (CDI), pursuant to California Insurance Code Section 1011c, for an Agreement of Reinsurance and Assumption by and among Legion Insurance Company, KM Insurance Company Ltd., Mutual Indemnity Ltd. and the Company, effective April 1, 1995. The agreement provides that the Company will assume certain workers' compensation and employer's liability insurance policies issued by Legion Insurance Company, and reinsured by Mutual Indemnity Ltd. and KM Insurance Company Ltd. The effective date of the consent by the CDI was December 31, 1995.

Ceded

The following is a schedule of the treaties in force as of December 31, 2001:

Line of Business and Type of Contract	Reinsurer's Name and Percentage of Participation	Company's Retention	Reinsurers' Maximum Limits
Workers' Compensation Per Occurrence Excess of Loss 1999			
1st Layer Excess of Loss	TIG Reinsurance Company	$100,000	$400,000 each loss occurrence
2nd Layer Excess of Loss	Connecticut General Life Insurance Company (50%) ReliaStar Life Insurance Company (50%)	$500,000	$4.5 million each loss occurrence
Catastrophe Excess of Loss	Connecticut General Life Insurance Company (33.3%) First Allmerica Financial Life Insurance Company (33.4%) ReliaStar Life Insurance Company (33.3%)	$5 million	$45 million each loss occurrence
Workers' Compensation Per Person Excess of Loss	Connecticut General Life Insurance Company (50%) Unum Life Insurance Company of America (50%)	$5 million	$5 million per person each and every loss occurrence, subject to an annual aggregate limit of $10 million

Line of Business and Type of Contract	Reinsurer's Name and Percentage of Participation	Company's Retention	Reinsurers' Maximum Limits
Automobile Quota Share 1998	Chartwell Reinsurance Company (35%) Republic Western Insurance Company (32.5%) TOA-Reinsurance Company of America (32.5%)	50%	50% of each loss
Employment Practices Liability Quota Share	Underwriters at Lloyds	10%	90% of $2 million each and every claim made any one insured, subject to annual aggregate of $3.6 million (90% of $4 million)
Automobile Quota Share 1999	Chartwell Reinsurance Company (35%) Republic Western Insurance Company (32.5%) TOA-Reinsurance Company of America (32.5%)	50%	50% of each loss
Automobile Quota Share 2000	Republic Western Insurance Company (50%) TOA-Reinsurance Company of America (50%)	75%	25% of each loss
Automobile Quota Share 2001	Swiss Reinsurance America Corporation	50%	50% of each loss with a loss ratio below 67% or between 90-113%. Company is responsible for all losses with a loss ratio in excess of 113%
Workers Compensation 2001 Quota Share	Odyssey America Reinsurance Corporation (50%) GE Reinsurance Corporation (50%)	50%	50% of losses up to $200,000
Workers' Compensation Per Occurrence Excess of Loss 2001			
1st Layer Excess of Loss	Odyssey America Reinsurance Corporation (50%) GE Reinsurance Corporation (50%)	$200,000	$300,000 each loss occurrence
2nd Layer Excess of Loss	Odyssey America Reinsurance Corporation (50%) GE Reinsurance Corporation (50%)	$500,000	$500,000 each loss occurrence
3rd Layer Excess of Loss	Odyssey America Reinsurance Corporation (50%) GE Reinsurance Corporation (50%)	$1,000,000	$4,000,000 each loss occurrence
4th Layer Excess of Loss	ReliaStar Life Insurance Company (50%) LDG Reinsurance Corporation/Transatlantic Reinsurance Corporation (50%)	$5,000,000	$45,000,000 each loss occurrence

All the participating reinsurers are admitted and authorized in the State of California.

Effective July 1, 2000, the reinsurers' participation in the automobile quota share treaty was reduced to 25% increasing the Company's retention for this line to 75%. The reinsurers' participation was increased back to 50% effective January 1, 2001.

As indicated earlier in this report, the Company has not entered into any reinsurance contracts for the automobile line of business for 2002. Failure to secure reinsurance for the 2002 writings could have a significant financial impact on the Company.

The Automobile Quota Share agreements for both 1999 and 2001 contain the words "or otherwise" in their offset provision. It is recommended that this language be deleted.

The Workers Compensation 2001 Quota Share, as well as the first, second and third layer excess of loss treaties all have a Special Termination Clause. Article 4, Special Termination, part 1B states:

> "Either party hereto shall have the right to terminate this Agreement, by providing at least 30 days advance written notice to the other party: if the other party has become unable to pay its debts or is insolvent or goes into liquidation"

Part 2 of the Special Termination clause goes on to say:

> "Further, either party hereto shall have the right to terminate this Agreement, by providing at least 60 days advance written notice to the other party, if John R. Sosak ceases to be involved in the day to day operations or is removed as President/CEO of Alistar Insurance Company."

John Sosak did not relinquish his position until January 7, 2002, and the Company discontinued writing the small workers' compensation book of business at the end of 2001. It is recommended that each agreement be revised to exclude the Special Termination Clause.

The Company entered into a commutation agreement with St. Paul Reinsurance Company, Limited on March 19, 2001 in which they agreed to settle all past and future losses on their workers compensation quota share treaty for the sum of $2,125,000. The Company received a wire transfer in this amount on April 2, 2001.

FINANCIAL STATEMENTS

The financial statements prepared for this report include the following:

Statement of Financial Condition as of December 31, 2001

Underwriting and Investment Exhibit for the Year Ended December 31, 2001

Reconciliation of Surplus as Regards Policyholders from December 31, 1996 through December 31, 2001

Reconciliation of Examination Changes as of December 31, 2001

Statement of Financial Condition
as of December 31, 2001

	Assets	Assets Not Admitted	Net Admitted Assets	Notes
Assets				
Bonds	$ 8,493,825	$	$ 8,493,825	
Cash and short-term investments	3,092,764		3,092,764	
Other invested assets	250,000		250,000	
Premiums and agents' balances in course of collections	4,919,924	63,235	4,856,689	
Premiums, agents' balances and installments booked but deferred and not yet due	445,996		445,996	
Reinsurance recoverable on loss and loss adjustment payments	2,660,629		2,660,629	
Guaranty funds receivable or on deposit	88,677		88,677	
Electronic data processing equipment	33,292		33,292	
Interest, dividends, and real estate income due and accrued	143,125		143,125	
Other assets nonadmitted	10,189	10,189		
Aggregate write in for other than invested assets	222,441	16,170	206,271	
Total assets	$20,360,862	$ 89,594	$20,271,268	

Liabilities, Surplus and Other Funds			
Losses		$13,441,488	(1)
Loss adjustment expenses		3,572,621	(1)
Commissions payable, contingent commissions		(464,456)	
Other expenses		212,095	
Taxes, licenses and fees		985,194	
Unearned premiums		2,384,639	
Ceded reinsurance premiums payable (net of ceding commissions)		2,977,282	
Amounts withheld or retained for accounts of others		22,504	
Premium deficiency reserve		210,000	(2)
Total liabilities		23,341,367	
Common capital stock	$ 2,500,000		
Gross paid in and contributed surplus	15,207,653		
Unassigned funds (surplus)	(20,777,752)		
Surplus as regards policyholders		(3,070,099)	
Total liabilities, surplus and other funds		$20,271,268	

Underwriting and Investment Exhibit
for the Year Ended December 31, 2001

Statement of Income

Underwriting Income		
Premiums earned		$21,677,200
Deductions:		
Losses incurred	$15,483,204	
Loss expenses incurred	5,957,986	
Other underwriting expenses incurred	10,010,017	
Total underwriting deductions		31,451,207
Net underwriting loss		(9,774,007)
Investment Income		
Net investment income earned	$ 789,939	
Net realized capital gains	14,456	
Net investment gain		804,395
Other Income		
Net gain from premium balances recovered	$ 348,906	
Aggregate write-ins for miscellaneous income	21,452	
Total other income		370,358
Net loss		$(8,599,254)

Capital and Surplus Account

Surplus as regards policyholders, December 31, 2000		$ 5,460,554
Net loss	$ (8,599,254)	
Change in nonadmitted assets	1,094,145	
Cumulative effect of changes in accounting principle	(1,011,709)	
Aggregate write-ins for losses in surplus	(13,835)	
Change in surplus as regards policyholders for the year		(8,530,653)
Surplus as regards policyholders, December 31, 2001		$(3,070,099)

Reconciliation of Surplus as Regards Policyholders
from December 31, 1996 through December 31, 2001

Surplus as regards policyholders, December 31, 1996, per Examination			$ (591,831)
	Gain in Surplus	Loss in Surplus	
Net loss	$	$13,878,934	
Net unrealized capital losses		70,615	
Change in nonadmitted assets		6,728	
Cumulative effect of changes in accounting principles		1,011,709	
Surplus adjustments: Paid-in	12,503,553		
Aggregate write-in for loss in surplus		13,835	
Total gains and losses	$12,503,553	$14,981,821	
Decrease in surplus as regards policyholders			(2,478,268)
Surplus as regards policyholders, December 31, 2001 per Examination			$(3,070,099)

Reconciliation of Examination Changes
as of December 31, 2001

Liabilities	Per Company	Per Examination	Surplus Increase (Decrease)	Notes
Losses	$11,759,056	$13,441,488	$(1,682,432)	(1)
Loss adjustment expenses	1,455,032	3,572,621	(2,117,589)	(1)
Premium deficiency reserve		210,000	(210,000)	(2)
Net decrease to surplus			(4,010,021)	
Surplus as regards policyholders, December 31, 2001, per Company			939,922	
Surplus as regards policyholders, December 31, 2001, per Examination			$(3,070,099)	

COMMENTS ON FINANCIAL STATEMENT ITEMS

(1) Losses and Loss Adjustment Expenses

The Company's losses and loss adjustment expenses (LAE) were reviewed by a California Department of Insurance Casualty Actuary. Based on his review, the Company's loss and LAE reserves were increased by $1,682,432 and $2,117,589, respectively, as follows:

Losses

Line of Business	Per Examination	Per Company	Increase (Decrease)
Workers' compensation	$ 6,733,364	$ 4,772,479	$1,960,885
Auto liability	6,323,938	6,457,600	(133,662)
Auto physical damage	86,323	231,113	(144,790)
Other liability	12,595	12,595	
Surety	285,268	285,269	(1)
Totals	$13,441,488	$11,759,056	$1,682,432

Loss Adjustment Expenses

Line of Business	Per Examination	Per Company	Increase (Decrease)
Workers' compensation	$ 1,288,466	$ 913,240	$375,226
Auto liability	2,064,902	314,716	1,750,186
Auto physical damage	6,480	14,303	(7,823)
Other liability			
Surety	212,773	212,773	
Totals	$3,572,621	$1,455,032	$2,117,589

(2) Premium Deficiency Reserve

A premium deficiency reserve was established for the substandard automobile business in accordance with Statement of Statutory Accounting Principles No. 53.

SUMMARY OF COMMENTS AND RECOMMENDATIONS

Current Report of Examination

Summary of Significant Findings (Page 1): The surplus as regards policyholders as of December 31, 2001 as determined by this examination was $(3,070,099). The Company is deemed insolvent pursuant to California Insurance Code Section 985. It also places the Company at the Mandatory Control Level for Risk-Based Capital.

Summary of Significant Findings (Page 1): Due to deteriorating loss experience, the Company on December 28, 2001 gave its general agent, CenCal Insurance Service, 90-days notice to terminate writing automobile business. The Company has not been able to obtain reinsurance for its 2002 automobile writings. Failure to secure reinsurance for the 2002 writings could have a significant negative impact on the Company financially.

Summary of Significant Findings (Page 1): The Company's managing general agent for its bail bond business, R. Spencer Douglass (RSD), is currently facing various felony charges.

Reinsurance – Ceded (Page 7): It is recommended that the Company remove the words "or otherwise" from its Automobile Quota Share offset clauses.

Reinsurance – Ceded (Page 7): It is recommended the Company revise its 2001 Workers Compensation Quota Share and Excess of Loss contracts to eliminate the special termination clause.

Previous Report of Examination

Summary of Significant Findings and Subsequent Events (Page 2): The Company was deemed statutorily insolvent as of December 31, 1996. The examination established assets of $8,948,480, liabilities of $9,540,311, and negative surplus as regards policyholders of $591,831. The ultimate controlling person of the Company, Mr. Vahan Chamlian, contributed $12.5 million to the Company during the period under examination.

Management and Control – Consulting and Service Agreements (Page 6): Various consulting and service agreements did not meet the standards established by the California Department Insurance for Agreements. These agreements have been cancelled.

Management and Control – Insurance Holding Company System Regulatory Act (Page 6): It was recommended that the Company review the California Insurance Holding Company System Regulatory Act, and comply with the filing requirements. The Company has complied with the filing requirements.

Reinsurance – Ceded (Page 7): It was recommended that the Company work with its reinsurers to amend the agreements to conform to California Insurance Code (CIC) Section 922.2. All of the reinsurance contracts cited in the prior report of examination have either been terminated or are now in compliance with the above code section.

It was recommended that the Company amend its reinsurance agreements to exclude the punitive damages from the extra contractual obligations for California risks. The wording in its 1997 agreements was changed to conform to CIC Section 533 and California Civil Code Section 1668.

Accounts and Records (Page 10): It was recommended that the Company develop a system of comprehensive controls. It was also recommended that the Company develop adequate audit trails and workpapers to support all balances that are reported in the Company’s annual and quarterly statements. During this examination, the Company implemented new software applications and established procedures and controls to address most of the problems noted during the previous examination.

It was recommended that the Company document a written business contingency/resumption plan. In this examination, we found that the Company does have a Disaster Recovery Plan; however, the plan lacked specifics for the physical transition to an alternate site. In addition, it contains no detailed specifications for hardware, software, or workspace requirements and needs to address its home office operations nor addresses its managing general agents in the plan.

Comments on Financial Statement Items – Cash and Short-Term Investments (Page 16): It was recommended that the Company review the National Association of Insurance Commissioners' Annual Statement Instructions – Property and Casualty manual and adhere to the reporting requirements for short-term investments. No discrepancies were noted in this examination with regard to reporting requirements for short-term investments. It was recommended that the Company establish procedures to properly account for the unclaimed funds and comply with the Unclaimed Property Law. The Company has established procedures to account for unclaimed funds and has complied with the Unclaimed Property Law during the period under examination.

Comments on Financial Statement Items – Premiums and Agents' Balances in Course of Collection (Page 16): The Company should establish procedures to include installments through the end of the accounting reporting period as nonadmitted assets on all policies for which one or more installments are over three months due. The Company has established procedures to comply with the above recommendation.

Comments on Financial Statement Items – Other Expenses (Page 17): It was recommended that the Company develop procedures to establish a more realistic Other Expenses liability. The Company has established policies and procedures that currently provide for a more realistic liability.

ACKNOWLEDGEMENT

Acknowledgement is made of the cooperation and assistance extended by the officers and employees of the Company during the course of this examination.

Respectfully submitted,

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Howard S. Wong, CFE
Examiner-In-Charge
Senior Insurance Examiner - Supervisor
Department of Insurance
State of California